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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

In the Matter of	)	
COMPUTER RESERVATIONS SYSTEM (CRS) REGULATIONS	)	Dockets OST-97-2881; OST-97-3014; OST-98-4775

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COMMENTS OF
EXPEDIA, INC.

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In the Matter of	)	
COMPUTER RESERVATIONS SYSTEM (CRS) REGULATIONS	)	Docket OST-97-2881

COMMENTS OF
EXPEDIA, INC.

Expedia, Inc. hereby submits these comments in response to the Supplemental Advance Notice of Proposed Rulemaking ("Supplemental Notice") issued by the Department of Transportation (the "Department") in this proceeding. *Supplemental Notice*, 65 Fed. Reg. 45,551 (2000). By that Supplemental Notice, the Department solicited further comments on, *inter alia*, whether 14 C.F.R. Pt. 255 (the "CRS Rules") should be amended to extend to some or all of the rules, which are currently applicable to one type of travel service, computer reservation systems ("CRSs"), to other types of travel services available to consumers through the Internet.

I. EXECUTIVE SUMMARY

Divided by ownership, two types of travel services exist – those that are owned or controlled to some degree by an airline, and those that are not. [1] Airline-owned travel

[1] Expedia, Inc., including all of its subsidiaries (collectively, "Expedia"), is an "independent" travel service, in that it is not owned or controlled by any airline. Expedia conducts its business principally over the Internet.

services, whether they are delivered over a computer, the phone or otherwise should be supervised by the CRS Rules because they generate many of the same concerns with regard to airline competition and consumer benefit that the Department designed the CRS Rules to prevent. Independent travel services, on the other hand – again, irrespective of the medium – should not be supervised by the CRS rules as their business model demands that they promote airline competition and consumer benefit.

In considering any extension of the CRS Rules, the Department should not focus on the means of distributing airline tickets, but rather on who controls that distribution channel and whether the entity or entities that have that control have the incentive and ability to manipulate the information they deliver through that distribution channel in order to erode airline competition and consumer benefit.

II. THE DEPARTMENT SHOULD NOT EXTEND THE CRS RULES TO INDEPENDENT TRAVEL SERVICES, INCLUDING INTERNET TRAVEL SITES.

The Department should not extend the CRS Rules to independent travel services, whether or not Internet-based, because such services promote, rather than erode, airline competition with an ultimate goal of serving consumers and receiving the consequent economic rewards.

The Department's initial promulgation and subsequent extension of the CRS Rules sought to increase airline competition and decrease consumer deception caused by the airlines' ownership of the CRSs and their use of such ownership to increase their respective ticket sales and control over certain geographic markets. At the time, airlines relied almost exclusively on travel agents for distribution, and travel agents relied on the airline-owned CRSs for flight and fare information and to make bookings. *Final Rule,*

Computer Reservations System (CRS) Regulations, 57 Fed. Reg. 43,780, 43,782-83 (1992) ("Final Rule") ("Carriers appear to have no practical substitute for [travel agency services]."). Travel agents generally used only one CRS and draconian contractual restrictions rendered the option of using any other CRS unfeasible. Naturally, each travel agent chose the CRS in which appeared the flight and fare information of the airline dominating the travel agent's market and, more importantly, they referred this information to their customers. *Id.* at 43,783.

Having built this captive audience, each CRS's airline-owner could and did then use the system to mislead consumers and prejudice competition, primarily by refusing to allow competing airlines to participate fully or on reasonable terms in its CRS, or by biasing its CRS so as to favor the airline-owner's flights, regardless of value. *Id.* at 43,786. These access and biasing concerns with airline-owned CRSs are what prompted the initial regulations and the 1992 extension. *Supplemental Notice*, 65 Fed. Reg. at 45,553 ("We based our decision to continue regulating the systems on their control by airlines and airline affiliates."); Final Rule, 57 Fed. Reg. at 43,793 ("We find that CRS Rules remain necessary to prevent deception and a substantial reduction in airline competition . . . .").

In short, the regulation of CRSs was fundamentally about incentive and ability – the incentive of airline-owners to mislead travel agents and consumers in order to discriminate against other airlines and protect themselves from competition, and the ability to do so, which was afforded by their control over both the supply – air tickets – and the systems displaying the availability of that supply – the CRSs.

Therein lies the crucial distinction between independent Internet travel services and airline-owned travel services, including CRSs and Internet travel sites: Independent travel services have little realistic incentive or ability to assist airlines in reducing airline competition. To the contrary, independent travel services, like Expedia, need airline competition and seek to promote it with an ultimate goal of offering value to consumers and receiving the consequent economic rewards.

Independent travel services promote airline competition by negotiating non-published, special fares with airlines. Airlines are interested in offering these special fares, which are often lower than those offered by the airline in other channels, because they want greater exposure to and share of the travel service's customers. Assuming more than one airline is interested in the travel service's customers, the airlines then compete for this exposure to and share of the travel service's customers by offering better and better deals to such customers. Independent travel services also provide a unique consumer benefit in that they are able to offer the airlines valuable consideration such as advertising space or special promotions in exchange for special fares that would not otherwise be offered to an individual consumer.

In essence, the independent travel service's interests are fundamentally aligned with the consumer's interests. Each wants lower fares and special promotions to be available – the consumer wants access to the lower fares in order to save money, and the independent travel service wants the fares in order to draw the consumer to its business in order to collect revenue. It is a "win-win" situation for both the customer and the travel service that is available only when airlines are competing.

Independent travel services also benefit the consumer by encouraging new entrants – and more competition – into an airline industry notoriously difficult to enter. Airline-owned travel services have little incentive to assist new competitors of their airline-owners. Independent travel services on the other hand have little incentive not to assist such competitors. Consequently, via independent travel services, new entrants are often afforded an independent and cost-efficient channel to market their businesses. Should they be even preliminarily successful, consumers benefit from the increased competition. Independent travel services – Internet travel sites in particular – also eliminate the captive market for air travel. At one time, CRSs were able to foreclose competitive fares to customers of travel agents forced to subscribe to the CRS by reason of geographic location. Today, technology and media have evolved to a point where consumers have quick and easy access to multiple competing travel services across the globe and the travel options and information that they offer. Consumers are thus able to select travel services that add value to their purchasing processes rather than those that hold them captive. If they are dissatisfied with a travel service, a competitor is only a phone call, mouse click or office visit away. Nowhere is this truer than in the Internet world, where sophisticated browsers permit immediate and often simultaneous access to competing Internet travel sites. Competition is alive and well among independent travel services, preventing individual airlines from utilizing their own travel services to hold consumers captive by foreclosing access to competing fares.[2] *See Advance Notice of*

[2] It is important to note, however, that it is difficult if not impossible for this robust competition to dissuade market captivity if it is imposed by the airlines operating in concert. If a collection of airlines chooses one channel of distribution as the exclusive channel for some or all of their inventory, similar to what they have proposed for Orbitz, then the airlines significantly undermine competing channels of distribution and captivity returns.

Proposed Rulemaking: Computer Reservations System (CRS) Regulations, 62 Fed. Reg. 47,606, 47,610 (1997) ("*ANPRM*") (circumstances that contributed to CRS influence over travel agent behavior unlikely to be true for consumer use of Internet travel sites).

The fact that these independent travel services are numerous and competitive underscores another reason why they should not be regulated as CRSs – none of them is an "essential facility." In drafting the Supplemental Notice to the CRS Rules, the Department correctly pointed out that the market manipulation of the airline-owners through their CRSs was analogous to the denial of access to an "essential facility" to competitors in order to gain an unfair competitive advantage and maintain monopoly power in air travel services. They were thus "unfair methods of competition," which provided a basis for regulation under Section 411 of the Federal Aviation Act, now codified at 49 U.S.C. § 41,712. *Supplemental Notice*, 65 Fed. Reg. at 45,554 ("An unfair method of competition is a practice that violates the antitrust laws or antitrust principles."). The thrust of the antitrust problem was the CRS airline-owners' exclusion of other airlines from full and fair participation in their CRSs on reasonable terms, which was necessary to compete in a particular geographic market. *Id.* Thus, the focus of the rules has always been on competition in the industry the Department regulates – airlines.

By contrast, no independent travel service in general, of which there are literally thousands, or any independent Internet travel site in particular, of which there are literally hundreds, is an essential facility for any airline. No independent travel service is capable of exercising monopoly power in air travel or travel services. Today, air travel sales flourish in multiple media, whether it be via the Internet, a telephone or a travel company's physical facility, giving the airlines and consumers innumerable options for

selling and buying air travel and distributing and receiving information. The true "essential facility" in this industry – airline ticket inventory – continues to be controlled by the airlines.

In conclusion, before applying the CRS Rules to any travel service, the Department must revisit the question of incentive and ability. Does the travel service have the incentive and the ability to lessen airline competition? With respect to independent travel services, including those conducted via the Internet, the answer is most certainly "no." Rather independent travel services stimulate airline competition so that they may properly serve their customers and, as a practical matter, be rewarded for doing so. The Department should not regulate such consumer-oriented activities.

III. THE DEPARTMENT SHOULD EXTEND THE CRS RULES TO INTEGRATED TRAVEL SERVICES IN WHICH ONE OR MORE AIRLINE OWNS MORE THAN FIVE PERCENT OF THE VOTING SECURITIES OF THE SERVICE, OR TOTAL COMBINED AIRLINE CONTROL OF THE SITE EXCEEDS TWENTY PERCENT.

Today, a travel service will generally fall under the CRS Rules if the following four elements are satisfied: (1) one or more airlines owns the service; (2) the service displays integrated fare information (i.e., it displays more than one airline's fares); (3) the service displays information via a computer; and (4) the service allows a travel agent in the United States to make reservations or issue tickets for air travel. 14 C.F.R. § 255.3.

When we focus on the evils that the CRS Rules set out to prevent – the incentives of airline-owners to mislead travel agents and consumers in order to disadvantage other airlines – there is simply no basis for distinguishing traditional CRS systems from any other medium controlled by the airlines through which consumers can be mislead. If an airline owns a service and wishes to bias the information displayed by that service,

whether the airline biases the information via telephone, facsimile, the Internet or any other medium should be irrelevant. Airlines have the incentive and the ability to manipulate their supply and harm competition among them – the medium does not. To focus solely on the computerized medium – particularly the Internet – leads to an odd result. A consumer would enjoy regulatory protection when it dials into an airline-owned Internet site but not when it dials an airline-owned 800 number, even though the airline owner of that 800 number has the same incentive to push the consumer to its own product.

A. The Department should expand the definition of a "system" to include travel services offering integrated information in which one or more airlines has an ownership interest greater than five percent, or in which all airline ownership interests together total at least twenty percent.

Airline-owned travel services offering integrated information, whether or not computer- or Internet-based, pose very similar dangers to competition as do airline-owned CRSs and should be considered "systems," particularly with regard to the rules concerning discrimination between participating carriers and the mandatory participation of airline-owners in other CRSs. 14 C.F.R. §§ 255.6, 255.7.

The simplest way to accomplish this goal is through the following changes to the existing CRS Rules: First, the Department should amend the definition of "system" thus (additions and deletions are noted by underlining and strikethroughs):

> *System* means a ~~computerized~~ reservations system offered by a carrier or its affiliate to subscribers or consumers for use in the United States that contains information about schedules, fares, rules or availability of other carriers and providers subscribers or consumers with the ability to make reservations and to issue or purchase tickets~~, if it charges any other carrier a fee for system services~~.

This amendment would remove the meaningless distinction between computerized and non-computerized methods of air travel distribution, while focusing the definition on the quality relevant to the threat to airline competition – carrier ownership.

Concurrently, the Department should draft an exemption for systems in which a single airline does not purport to offer integrated information (*e.g.*, Southwest Airline's Internet site), as such systems do not hold themselves out as neutral sources of information and thus neither affect the market for air travel services nor pose a significant threat of consumer deception. *See Supplemental Notice*, 65 Fed. Reg. at 4557 ("No one has yet suggested . . . that we adopt rules governing websites operated by individual airlines . . . .").

Finally, the competitive harm caused by certain collaborations among airline competitors who each own less than five percent of a system should be addressed by amending the definition of a "system owner" thus:

> *System owner* means a carrier that holds five percent or more of the equity of a system, or has one or more affiliates that hold such an equity interest, that together with affiliates holds such an interest~~.~~, or that together with affiliates, other carriers, and affiliates of other carriers holds twenty percent or more of the equity of a system.

Twenty percent is the market share threshold, adopted by the Department of Justice and the Federal Trade Commission in their recently released Antitrust Guidelines for Collaborations Among Competitors ("Guidelines") (April 2000), below which a competitor collaboration is deemed not to have a significant potential for anticompetitive harm. *Id.* § 4.2. Similarly, an airline-owned Internet site in which total airline ownership is less than five percent individually and less than twenty percent collectively would not

have a dangerous incentive to align its interests with those of any particular airline-owner or group of airline owners.

B. At a minimum, the Department should expand the definition of a "system" to include all airline-owned travel services offering integrated fare information.

Recently, the phenomenon of airline-owned travel services offering integrated fare information has expanded from the CRS to the Internet. This has initially appeared in the form of two Internet websites: Orbitz, a joint venture among American Airlines, Delta Air Lines, United Air Lines, Northwest Airlines, and Continental Air Lines, and Hotwire, a joint venture among American Airlines, United Air Lines, Northwest Airlines, Continental Air Lines, US Airways Group and America West Airlines.

Airline ownership of these Internet travel services presents the same potential for harm to competition that was posed by the initial airline ownership of CRSs. At a minimum, the CRS Rules should apply to these services because, if left unregulated, their member airlines will have a tool to entrench their market position vis-à-vis non-member airlines, and will be ideally situated to collude on prices and limit fare discounts offered to consumers.

As noted *supra*, one primary motivation for the initial adoption and extension of the CRS Rules was to prevent CRS airline-owners from (1) limiting their participation in other CRSs as a means to force travel agents to contract with their own CRS exclusively, and (2) refusing competitors' access to CRSs they owned as a means to monopolize air travel in the markets served by the CRSs they owned. These same concerns apply to airline-owned travel services such as Orbitz and Hotwire. The airline-owners of Orbitz and Hotwire can limit their airline-owners' participation in other Internet travel sites, thus

forcing consumers to deal solely with Orbitz for unpublished and special Internet fares. They can also limit the participation of their competitors in the site, thus facilitating a group boycott that will shore up the market share of the member airlines.

Orbitz has already taken steps to ensure at least the former outcome. It and its member airlines have made numerous statements that Orbitz will be the exclusive provider of the lowest fares available on the Internet.[3] In addition, the participation agreements between Orbitz and member airlines include so-called "Most Favored Nations" or "MFN" clauses requiring that any fare offered by participating airlines through any other Internet travel site also be offered on Orbitz. The Orbitz participation agreements also require promotional commitments of the member airlines, which can be satisfied by offering Orbitz-exclusive fares.[4]

The cumulative effect of these exclusivity provisions will be the eventual destruction of competition for the sale of unpublished and Internet fares. Even if only the MFN provisions are enforced, airlines will have no incentive to offer special deals to consumers through other Internet travel services because they will be required to offer them through Orbitz as well, and this requirement will diminish the profitability promised by a more limited promotion of a special fare. Thus, an important channel of distribution and competition will be extinguished. Orbitz, with command of all of the inputs

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[3] See Statement of Donald Carty, CEO, American Airlines, Hearing before the Senate Subcommittee on Antitrust, Business Rights and Competition (May 2, 2000) ("It is envisaged by [Orbitz] that some offerings will be made on this site that won't be made on other sites, at least by the equity owners of the airlines."); Alex Zoghlin, Chief Technology Officer, Orbitz, Internet World, June 1, 2000 ("We're getting the same stuff as everyone else, except that the special fares that are on the Web sites of particular airlines, we are putting into one place to book.").

[4] *See* Airline Charter Associate Agreement, Section 2.2 ("Airline shall provide [Orbitz] with In-Kind Promotions . . . implemented in accordance with the valuation methodology in Exhibit B."), Exhibit B ("In-Kind Promotions may include . . . Exclusive promotions or fares available only on [the Orbitz] Site.").

necessary to compete in the sale of air travel on the Internet (i.e., fares and tickets), will quickly come to dominate that market.

However, even without the exclusivity provisions and MFN clauses, Orbitz poses a serious threat to competition in the airline industry. Its very structure – based upon wide-spread airline ownership and control – provides a strong incentive for the member airlines to favor a distribution channel in which they capture the profits that independent sites need to attract and keep both customers and investors. Deprived of an opportunity to earn a reasonable return, competing Internet travel services will exit the market and Orbitz's airline owners will eventually effect the same injury to competition that their exclusivity provisions and MFN clauses would achieve, *i.e.,* Orbitz will dominate the market. [5]

Once competition is reduced (or eliminated altogether), the airline-owners of an unregulated site such as Orbitz will have every incentive to begin charging non-member airlines heavy premiums for participation. In the case of Orbitz, this incentive is particularly strong, as included among the airline-owners of Orbitz are the five airlines that control ninety percent of the market for domestic air travel. New entrants in the market for air travel will suffer as they face higher costs than their more established competitors to participate in a necessary distribution outlet. Orbitz or other sites owned

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[5] The airlines have cited, as a justification for Orbitz's existence, the fact that Orbitz will be a less expensive channel of distribution because it will refund to the airlines certain fees paid to Orbitz from their CRS. Any savings, however, would be temporary at best, since once the airlines come to dominate the Internet travel service business, consumers will more than pay for any such "savings" though higher airfares, as the airline competition induced by independent Internet travel services is neutralized. Still, some, including the Department's Inspector General, have suggested that it may be equitable for the airlines to offer such fares to other travel services as long as they are willing to pay similar rebates to the airlines. While the intent of this suggestion is to eliminate the airlines' collusive favoritism for their own channel, it also opens the door for additional collusion among the airlines by allowing them – rather than competitive forces – to collectively dictate via Orbitz the level of these rebates for all market participants.

by multiple airlines would become essential facilities, just as the CRSs were considered essential facilities by the Department at the advent of the CRS Rules.

Without competing Internet distribution outlets, nothing would prevent the airline-owners of Orbitz from biasing displays in favor of airline-owners and against new entrants or non-owner airlines. Although not dangerous to airline competition in the presence of multiple competing Internet travel sites, this development would be disastrous in their absence, just as display bias or participation discrimination was of serious concern in the exclusive markets of the initial CRSs. The airlines could leverage their Internet dominance to begin restricting special fares from other competing channels, such as bricks and mortar travel agents.

In the end, although Orbitz hails its exclusive fares as "one stop shopping" that will benefit consumers, it will instead *remove* certain fares from the market – all because of Orbitz's airline ownership. This threat is real and immediate, and, at a minimum, the Department should amend the CRS Rules to cover such airline-owned Internet travel sites.

C. As a general matter, the Department should prohibit Most Favored Nations clauses in contracts between airlines and airline-owned travel services, including airline-owned Internet travel sites.

14 C.F.R. § 255.6(e) currently prohibits a system from requiring a carrier to maintain a particular level of participation in the system on the basis of participation levels in other computer reservations systems. The only exception to this is if the carrier also owns or markets a system, or is an affiliate of one that does. This prohibition should

also extend to forced participation on the basis of participation in any other method of ticket distribution, including independent Internet travel sites.[6]

Such forced participation (commonly known as "MFN clauses") generally dampens the willingness of airlines to advertise very low fares in "non-MFN" channels because, when offered to more than one channel, a large and inefficient amount of inventory will be sold at those fares. Removing the ability of independent travel services to negotiate special deals that will not be distributed widely to competitors diminishes the incentive of these services to negotiate for any low or special fares, for the system that imposes the MFN clause (e.g., the airline-owned service) will reap the benefits of the independent services' negotiations and investments. Eventually, when all customers begin to look only to the airline-owned service and the independent services are out of the air travel business, there will be no incentive for the airline-owned service to bargain with airlines on behalf of consumers. *Cf. ANPRM*, 62 Fed. Reg. at 47,609 ("We have tentatively concluded that [CRS participation parity contract clauses] unreasonably reduce competition in the CRS and airline industries.").

Finally, MFN clauses, when undertaken by an airline-owned travel service with a significant percentage of the air market participating (*e.g.*, Orbitz), provide the participating airlines with near-perfect visibility into each other's non-published fare inventory. Just as this transparency exists today in the sphere of published fares, collusion would become easier as the airlines gained instant knowledge of what "special deals" their competitors are cutting with other distribution outlets. Member airlines

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[6] As with the amendments to the definition of a "system," a general exception should apply to the proprietary travel services of carriers and their affiliates that do not display integrated information.

would then have little incentive to quietly reduce prices in select markets in order to gain market share because they would then be obligated to tip-off their competitors by sharing those fares with the airline-owned travel service. This could potentially ignite a fare war within their own channel of distribution. Orbitz has already signaled its intentions to avoid such an outcome by touting itself as being forever "neutral" or "non-biased." In effect, this means that Orbitz's members will not compete with one another for market share in this channel so that the status quo is always preserved and fare wars are an impossibility.

In conclusion, MFN clauses are inherently problematic when incorporated into contracts between airlines and airline-owned systems. Accordingly, § 255.6(e) should be amended to prohibit MFN clauses between such entities with respect to any method of air ticket distribution.

IV. CLOSING REMARKS

We respectfully request that the Department, in considering an extension of the CRS Rules, be mindful of the differing incentives and abilities of airline-owned travel services versus independent travel services as they distribute airline tickets to consumers. There is a bright line here that cuts across all mediums, whether computer-, Internet-, telephone- or facsimile-based. Ironically, perhaps an airline said it best – in this case Southwest Airlines – in its testimony submitted to the Senate Commerce Committee as part of the hearing entitled "Internet Sales of Airline Tickets":

"Consumers are entitled to fare and schedule information that is unfiltered and unrestricted by a consortium of the major airlines. Consumers are also entitled to continue to receive the benefits of low-fare competition provided by Southwest and

others, free from *collective* efforts to suppress it. Joint ventures of the major airlines like Orbitz should not be permitted to interfere with these worthy and proper expectations of the public."

Respectfully submitted,

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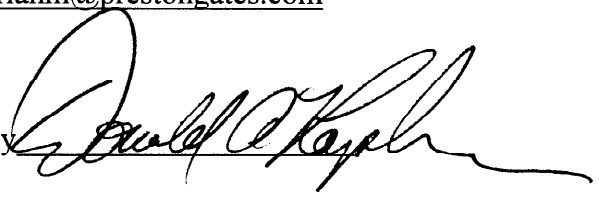
By 

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